Antitrust and Class Action Advisory

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New Seventh Circuit Decision Endorses Heightened Scrutiny of Experts at Class Certification Stage While Potentially Lowering the Bar to the Predominance Element at Class Certification

BY BRUCE D. SOKLER, KEVIN M. MCGINTY, ROBERT G. KIDWELL, AND CHRISTI J. BRAUN

In the health care antitrust world, the Federal Trade Commission (FTC) *Evanston* case, involving a retrospective attack on the consummated merger between Evanston Northwestern and Highland Park hospitals, is an important government enforcement benchmark. Now in a private antitrust class action, the Evanston merger continues to make important law, both with respect to class certification issues and the analysis of antitrust harm in the private class context when differential pricing is present.

Some commentators have been quick to hail the Supreme Court's landmark decision in *Wal-Mart Stores, Inc. v. Dukes,* 131 S. Ct. 2541 (2011), as a broad win for all class action defendants. In particular, the court's endorsement of the evaluation of merits issues at the class certification stage – including dicta favoring the exclusion of unreliable expert testimony submitted at the class certification stage pursuant to Fed. R. Evid. 702 and *Daubert v. Merrell Dow Pharmaceuticals, Inc*., 509 U.S. 579 (1993) – has been portrayed as imposing additional obstacles to certification of plaintiff classes. The Seventh Circuit's recent opinion in *Messner v. Northshore University HealthSystem*, No. 10-2514 (7th Cir. Jan. 13, 2012), suggests that these developments may not inevitably spell doom for class certification. Following *Dukes*, the decision in *Messner* approves intensive examination of merits issues at the class certification stage, and highlights the critical role that reliable expert testimony plays in class certification by mandating *Daubert* review at the class certification stage when expert opinions are material to the decision. In doing so, however, the Seventh Circuit demonstrated that the *Dukes* decision does not change the critical role of the predominance inquiry in the certification of Fed. R. Civ. P. 23(b)(3) classes.

Further, the Seventh Circuit's application of the predominance element in *Messner*, if it migrates beyond the somewhat unique circumstances of a private damage challenge to a consummated merger, may have the effect of easing the plaintiffs' class certification burden in antitrust cases. The lenient approach to the predominance element in *Messner* may point towards increased reliance by defendants on motions to decertify classes under Fed. R. Civ. P. 23(c)(1)(C) at the summary judgment stage, when facts are more fully evolved and proof that common issues of fact and law will not predominate at trial may be better developed.

Original Antitrust Scrutiny of the Evanston-Highland Park Merger

Messner arose out of the January 2000 merger of Northshore University HealthSystem ("Northshore,"

then known as Evanston Northwestern Healthcare Corporation) and Highland Park Hospital. The merger attracted antitrust scrutiny as the target of an FTC retrospective administrative challenge to the consummated hospital merger. The FTC staff prevailed before an administrative law judge, who ordered the merger be undone through a divestiture. Upon an appeal to the Commission itself, the FTC found that the merger violated the antitrust laws, but declined to order divestiture, choosing instead to impose conduct remedies, requiring the merged hospitals to each contract separately with payors. Both the administrative law judge and the FTC based their findings of liability on direct evidence of market power, consisting of an econometric analysis that demonstrated that the merged hospitals raised prices to payors by a materially higher percentage than a control group of comparable hospitals.

Follow-On Class Action Litigation

Messner, a follow-on private antitrust suit challenging the merger, was filed in 2008, shortly after the conclusion of the FTC proceeding. The plaintiffs in *Messner* were four different direct purchasers of health care services from Northshore who alleged that, as a result of the January 2000 merger, Northshore acquired monopoly power over health care services in the relevant geographic market. As a result, plaintiffs claimed that Northshore abused, and continues to abuse, its monopoly power to maintain market dominance by unreasonably restraining trade, and thus artificially and anti-competitively raising the price of health care services to plaintiffs and members of the putative class. Plaintiffs sought treble damages and certification of a class of patients and third-party payors who allegedly paid higher prices for care.

Class Certification Proceedings in the Trial Court

Rule 23(b)(3) allows class certification only if the questions of law or fact common to the entire class "predominate" over questions that are individual to members of the class. As is typical in antitrust class actions, the motion for class certification in *Messner* focused on the predominance requirement and, in particular, whether antitrust injury could be established for the class as a whole through proof common to all class members.

To prove antitrust injury flowing from the merger, plaintiffs would have to prove that increases in prices charged by Northshore resulted from its alleged monopoly market power, and not from other unrelated factors. Like the FTC, plaintiffs relied on an economic expert who opined that proof of common impact could be established for all class members by means of a so-called "difference in differences" methodology, whereby increases in prices charged by Northshore would be compared to price increases charged by other benchmark providers, with the amount by which Northshore's charges exceeded the benchmark charges establishing the impact of Northshore's monopoly power. Northshore countered with an expert who disputed the validity of the plaintiffs' expert's methodology, while conceding that some price increases by Northshore did exceed benchmarks. Defendants further argued that the "difference in differences" methodology failed to establish common impact because it did not establish that prices were increased uniformly for all members of the class, thus requiring individual inquiries on the existence of antitrust injury.

Plaintiffs moved to strike the report of Northshore's expert, arguing that it was fundamentally defective and should be wholly stricken under FRE 702 and *Daubert*. The trial court denied plaintiffs' motion to strike. While the trial court agreed that the report contained "some misleading information and analysis," the court concluded that plaintiffs had been given adequate opportunity to respond to the report and that, rather than undertaking a *Daubert* analysis, the court would simply give the report of Northshore's expert "the weight it believes it is due."

The trial court then denied plaintiffs' class certification motion. The judge accepted defendants' argument that plaintiffs' expert's methodology of calculating antitrust impact on a class-wide basis required proof that defendant raised its prices at uniform rates affecting all class members and held that, because plaintiffs could not show class-wide injury, they could not satisfy the Rule 23(b)(3) predominance requirement. Plaintiffs appealed.

The Seventh Circuit's Decision

The Seventh Circuit vacated the district court's decision to deny class certification. The appellate panel held that price uniformity mandated by the district court was not required to sustain the predominance requirement for class certification and that common evidence – such as the post-merger price increases Northshore negotiated with third-party payors – showing that payors and patients suffered antitrust injury as a result of the merger was enough to satisfy the predominance requirement of Rule 23(b)(3). Several aspects of this ruling are significant for class action and antitrust practitioners.

Potential for expanded approval of ***Daubert*** review at class certification stage

Messner reinforces the Seventh Circuit's position that expert evidence that is offered in support of class certification must meet the reliability standards under FRE 702 and *Daubert* in order to be admissible at the class certification stage. The Seventh Circuit stated that an explicit *Daubert* ruling is required whenever an expert's report is critical to class certification, and that if the district court has any doubt about whether the report is critical, it should err on the side of making the *Daubert* ruling. Before the hearing on class certification, the district court in *Messner* had declined to undertake a *Daubert* analysis despite doubts regarding the reliability of the Northshore expert's report, finding that the plaintiffs had ample opportunity to respond to it in their reply brief and at oral argument, and the court had given the report "the weight it believes it is due." The Seventh Circuit disagreed, holding that the district court had an obligation to undertake a *Daubert* analysis at the class certification stage unless the court believed the expert opinion was not relevant to the predominance inquiry. *See American Honda Co. v. Allen*, 600 F.3d 813, 815-816 (7th Cir. 2010) ("When an expert's report or testimony is 'critical to class certification,' we have held that a district court must make a conclusive ruling on any challenge to that expert's qualifications or submissions before it may rule on a motion for class certification.").

The Seventh Circuit has provided the strongest endorsement of all of the circuits for the application of *Daubert* at the class certification stage. The *Messner* decision, coming as it does in the wake of dicta in *Dukes* doubting the proposition that *Daubert* does not apply at class certification, *see* 131 S. Ct. at 2554, adds to the expanding judicial approval for the application of *Daubert* to the testimony of experts submitted in support of or in opposition to class certification. The technical conflict between the Circuits based upon pre-*Dukes* rulings on the issue may yet require the Supreme Court to more squarely resolve this important question.

Application of ***Dukes*** does not automatically disfavor class certification

As the decision in *Messner* suggests, early reports of the "death of the class action" following the Supreme Court's decision in *Wal-Mart Stores, Inc. v. Dukes* may have been, in Mark Twain's words, "greatly exaggerated." Although *Dukes* places greater emphasis on the commonality requirement under Rule 23(a)(2) and restricts certification of classes seeking money damages under Rule 23(b)(2), the court's holding that it is appropriate to make a searching inquiry at the class certification stage, even if that inquiry intrudes on the merits, does not inevitably weigh against class certification. The burden to establish the elements of Rule 23 based on the evidence rather than on mere allegation does not alter the substantive requirements of Rule 23, including the predominance requirement under Rule 23(b)(3). As the decision in *Messner* demonstrates, courts can and will continue to decide that evidence marshaled by plaintiffs satisfies the requirements of Rule 23(b)(3).

Messner's implications for plaintiffs in antitrust class actions

To date, governmental attacks on consummated mergers are rare. Even rarer are private treble damage class actions challenging mergers. One reason is that when differential pricing exists, it has been thought to be difficult to demonstrate antitrust impact, antitrust injury, and damages through common evidence.

In this case at least, the court was willing to find predominance based upon a showing through econometric evidence that overall pricing was higher post-merger than could be justified, absent the existence and exercise of market power. The court was therefore willing to defer or pass over the thorny question as to how to determine damages on a class-wide basis when the transaction and pricing data were extremely complex.

How groundbreaking this approach will turn out to be will have to wait for future developments in this case and/or whether this approach to predominance for these substantive antitrust issues will be utilized in other than this rare, consummated merger context.

Decertification may be a viable option for defendants in some cases

Where a class is certified early in the case, before facts are fully developed, the individualized nature of issues that will need to be tried may not be as readily apparent as might be the case later on in the litigation. At the conclusion of discovery, when a defendant is likely to move for summary judgment, issues identified by plaintiffs as material disputed issues of fact could also constitute individualized factual inquiries that would preclude trying the case as a class action. Where that is the case, Rule 23(c)(1)(C) permits a defendant to move to decertify the class, possibly in the alternative to a motion for summary judgment. The refinement and focusing of factual and legal issues that occur at the summary judgment stage will often make it difficult for courts to adhere to the reductivist approach employed by the Seventh Circuit in *Messner*, by highlighting the complexity of issues that would have to be presented to the jury for trial.

The viability of decertification will vary from case to case. In some instances the sheer magnitude of the exposure resulting from class certification will counsel prompt settlement of the dispute once the class is certified. In other cases the motion of class certification may itself not occur until after the conclusion of discovery, a likelihood that is increased by the Supreme Court's approval of intensive merits examination at the class certification stage. In a case like *Messner*, however, a defendant may be able to have a second bite at the certification apple, and should strongly consider crafting its discovery and litigation strategy to make that option viable.

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